2016

Fiscal and Economic Update

Newfoundland Labrador

Fiscal Update

The Provincial Government remains committed to the fiscal targets set in Budget 2016, exceeding the target for the 2016/17 deficit and maintaining its commitment to return to surplus in 2022/23.

Budget 2016 forecast a deficit of $1.83 billion. This has been adjusted to $1.58 billion primarily the result of a $217 million improvement on total revenue and a $50 million reduction in the $125 million risk adjustment.

The revenue improvement of $217 million is primarily due to higher offshore oil royalties. Oil royalties, which were forecast at budget to be $502 million, are now projected at $601 million due to higher than anticipated oil prices and production. Given the improvement in revenues, the Department of Finance has reduced the risk adjustment accordingly.

Program expense savings of $111.1 million are offset by increased debt servicing expenses of $131.6 million, resulting in total expenses increasing by $20.5 million. The primary change is due to revised actuarial assumptions relating to pension and other post-employment benefits.

The Provincial Government plans to achieve more efficient public sector operations, including achieving deficit reduction targets, eliminating excess and employing an overall approach that ensures all spending decisions are justified on a year by year basis, with no automatic assumptions about spending from year to year.

Statement of Operations 2016-17

	2016-17 Budget	2016-17 Fall Update	Variance
Revenue	6,367.9	6,567.7	199.8
Net Income of Government Business Enterprises	408.4	425.5	17.1
Total Revenue	**6,776.3**	**6,993.2**	**216.9**
Gross Expenses:			
Program Expenses	7,499.0	7,387.9	(111.1)
Debt Servicing Expenses	982.3	1,113.9	131.6
Total Expenses	**8,481.3**	**8,501.8**	**20.5**
Risk Adjustment	**(125.0)**	**(75.0)**	**50.0**
Adjusted Deficit	**(1,830.0)**	**(1,583.6)**	**246.4**

Borrowing Requirement

2016/17 borrowing requirements have been reduced by $500 million from $3.4 billion to $2.9 billion. This is due primarily to higher revenues and cash-flow savings associated with infrastructure spending. $2.4 billion of this requirement has been completed to date.

Net Debt

Net debt as of March 31, 2017 is now projected to be $14.6 billion versus $14.7 billion at Budget.

Economic Update and Outlook

Global

Global growth has been decelerating since its most recent peak of 4.2% in 2011. The slowing growth is, to a certain extent, attributable to slower growth in emerging market economies (EMEs), most notably China. In addition, economic uncertainty looms over Europe as a result of the United Kingdom's decision to leave the European Union.

For the past several years, growth in EMEs, particularly China, was the main driver of global growth. During the first decade of the new millennium, China, currently the world's largest economy, recorded annual average real GDP growth of 10.5%. In contrast, China's economic growth has decelerated over the past five years, falling to 6.9% in 2015. This slower growth is negatively impacting demand for commodities. On the other hand, the decline in oil prices is boosting consumption, especially in major oil importing countries.

The slowing of economic growth in the EMEs, combined with oversupply, has placed downward pressure on several commodity prices, such as oil and iron ore. These prices have improved since the beginning of 2016, but their prices remain relatively low compared to recent peak levels. For example, the price of crude oil (Brent) in September 2016 was approximately 60% lower than the level recorded in June 2014. This has negatively affected most commodity exporters, including Russia and Brazil which are currently in recession. Although Canada is considered a commodity exporter, it has remained relatively resilient to the downturn, but not uniformly across provinces.

The IMF projects a 2016 growth rate in real GDP of 3.1% for the world, 1.6% for advanced economies and 4.2% for EMEs. Global growth of 3.4% is expected in 2017.

Canada

Expectations for 2016 Canadian real GDP have been revised downwards slightly since the spring of 2016, from 1.5% growth at budget time to 1.2% growth currently, a variance of -0.3 percentage points. Improving market conditions in the U.S. should continue to help economic performance in manufacturing intensive provinces, such as Québec and Ontario, and other provinces less dependent on oil and mineral exports, such as British Columbia and Manitoba. Reduced commodity prices will likely continue to restrain growth in the more oil and mineral resource-based provinces, such as Newfoundland and Labrador, Saskatchewan and Alberta. British Columbia, Manitoba and Ontario are expected to lead the provinces in growth this year.

Newfoundland and Labrador

Economic projections are generally on par with Budget 2016 projections. Real GDP is expected to increase slightly in 2016 due to an increase in exports stemming from higher oil production. However, capital investment and consumer and government spending are expected to decline affecting employment and income growth. Nonetheless, these indicators are expected to remain relatively high in historical terms. For the year as a whole, real final domestic demand is expected to decrease by 1.2%, while real GDP is forecast to grow by 0.6%.

Capital investment is expected to total $10.9 billion this year, down slightly from 2015. Lower spending on Vale's nickel processing facility in Long Harbour and the Hebron oil project, as well as lower residential

Economic Indicators Forecast (Calendar Year)
Budget vs Fall 2016 and Latest 2017 Forecast
(per cent change unless otherwise indicated)

	2016 Budget	2016 Fall	Change Budget vs Fall	2017 Fall
Real GDP	1.0	0.6	-0.4	-4.5
Household Income	1.0	0.5	-0.5	-2.6
Retail Sales	1.5	0.8	-0.7	-1.5
Consumer Price Index	2.2	2.5	0.3	2.4
Housing Starts	-15.5	-15.8	-0.3	-14.3
Capital Investment	0.6	-0.7	-1.3	-12.2
Population	-0.1	0.3	0.4	-0.7
Employment	-1.0	-1.3	-0.3	-4.2
Unemployment Rate (%)	12.8	13.2	0.4	15.1
Participation Rate (%)	60.6	60.4	-0.2	59.6

expenditures, will offset higher spending on the Muskrat Falls development. Total residential spending (including renovations) is expected to be $1.4 billion this year, a decline of 7.8% compared to 2015 and consistent with lower housing starts.

Labour markets continued to soften in 2016. Both employment and average weekly earnings decreased so far this year, leading to a decline in total compensation of employees. Employment declined by 1.1% in the first nine months of 2016 compared to the same period of 2015 and the labour force fell by 0.7%. The decline in the labour force stemmed from a drop in the participation rate (from an average of 61.4% in the first nine months of 2015 to 60.7% in the same period of 2016). The decrease in employment led to a 0.4 percentage point increase in the unemployment rate to 13.2%. Average weekly earnings fell by 0.8% in the first seven months of 2016 compared to the same period of 2015 but at $1,010 were still the second highest level among provinces after Alberta. The decline in employment and wages led to a 0.4% decrease in total compensation of employees for the first six months of 2015.

Despite a slight decline in economic activity and employment, the province's population grew by 0.3% in 2016, exceeding earlier expectations of population growth. This marks the ninth consecutive year of population growth.

Outlook

A contraction in the economy of Newfoundland and Labrador began in 2014 and is expected to continue for several years. Initially, low commodity prices dampened short-term resource investment and contributed to the closure of some mining operations. In addition, lower levels of capital investment due to the winding down of development of several major projects have been and will continue to be a drag on economic growth. Furthermore, government deficit reduction measures are expected to curtail expenditure growth in the public sector in the future. Taken together, these factors are expected to negatively impact GDP growth in the province.

In 2017, the largest impact on the economy will come from a decline in capital investment as Hebron and Vale's nickel processing facility move closer to completion. Capital investment is expected to decrease by 12.2%. The completion of these projects will also result in a decline in employment and income which is expected to dampen consumption growth. Lower investment and consumption are expected to result in a decline in final domestic demand (real terms) of 6.2%. Economic growth is expected to remain weak for several years beyond 2017 as further declines in capital investment are incurred and provincial government expenditures are reduced to improve its fiscal balance.

While growth is expected to be challenged in the near term, a number of positive developments are occurring in the provincial economy. Development of the underground mine at Voisey's Bay will extend production from the mine out to 2030. The Hebron oil project and the Long Harbour nickel processing plant are adding to long-term productive capacity to the economy. Furthermore, significant capacity enhancements in transportation infrastructure, such as those at St. John's International Airport and the Marine Atlantic ferry; the completion of the St. John's convention centre; and the continued addition of new capacity in the accommodations sector should facilitate growth in the tourism sector.

Furthermore, there is significant long-term potential in the NL economy, particularly in the energy sector. There are substantial oil and gas resources offshore Newfoundland and Labrador as evidenced by two recent resource assessments (one in the Flemish Pass and one in the West Orphan Basin). The resource assessment in the Flemish Pass indicated a resource potential of 12 billion barrels of oil and 113 trillion cubic feet of natural gas while the one in the West Orphan Basin estimated a resource potential of 25.5 billion barrels of oil and 20.6 trillion cubic feet of gas.

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